LIBRARY
SUPREME COURT, U.S.

Office - Supreme Court, U.S.
FILED
NOV 6- 1952
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1952

NO. 80

THE UNITED STATES OF AMERICA,
Petitioner,

v.

STEVENSON-CHISLETT, INC.,
Respondent.

On Certificate from the United States Court of Appeals for the Third Circuit.

BRIEF FOR THE RESPONDENT

DAVID B. BUERGER,
GEORGE M. HEINITSH, JR.,
1301 Alcoa Building,
Pittsburgh 19, Pennsylvania,
Attorneys for the Respondent.

SMITH BROS. CO. INC., LAW PRINTERS, 434-436 BLVD. OF ALLIES, PITTSBURGH 19, PA.

INDEX

		PAGE
I.	Opinions Below	1
II.	Jurisdiction	2
III.	Question Presented	2
IV.	Statute and Regulations Involved	3
V.	Counter-Statement of the Case	4
VI.	Summary of Argument	4
VII.	Argument	8
	I. When the Time of Actual Embezzlement Is Unknown the Deduction of an Embezzlement Loss in the Year of Discovery Is Supported by the Decided Cases and by the Applicable Treasury Regulations	8
	II. A Proper Construction of the Statute Permits the Deduction of an Embezzlement Loss in the Year of Discovery When the Year of Actual Taking Is Unknown	19
	III. The Logical Corollary of the Rule That an Embezzlement Creates a Debtor-Creditor Relationship Is That the Victim of the Embezzlement Does Not Sustain a Loss Until the Embezzlement Is Discovered and Its Amount Determined	25
	IV. In Any Event, Where the Year of Actual Embezzlement Is Unknown, an Embezzlement Loss Is Deductible in the Year of Discovery, in Order to Clearly Reflect the Income of the Taxpayer	30
Conclusion		36

TABLE OF CASES

PAGE

Alison v. United States, 97 F. Supp. 959 15
American Code Co., Lucas v., 280 U. S. 445 22
Bentley, J. A., 5 B.T.A. 314 13
Boehm v. Commissioner, 326 U. S. 287 ..... 18, 23, 24
Borden v. Commissioner, 101 F.2d 44 ..... 4, 13
Boston Consolidated Gas Co. v. Commissioner, 128 F.2d 473 ..... 4, 5, 6, 9, 18, 27
Dixie Pine Products Co. v. Commissioner, 320 U.S. 516 ..... 5, 24
Felton, Samuel M., 5. T. C. 256 11
First National Bank of Sharon v. Heiner, 66 F.2d 925 ..... 4, 15
Gilpin, Lucy D., 6 T.C.M. 370 11
Gwinn Brothers & Co., 7 T.C. 320 ..... 5, 6, 11, 18, 28
Huff, Burnet v., 288 U. S. 156 ..... 5, 14, 23
Louisville Trust Co., Glenn v., 124 F.2d 418 10
Lykes v. United States, 343 U.S. 118 18
McKnight v. Commissioner, 127 F.2d 572 27
Miglietta, Maria G., 1 T.C.M. 499 10
Peterson Linotyping Co., 10 B.T.A. 542 26
Piedmont Grocery Co. v. United States, 66 Ct. Cl. 468 29
Security Flour Mills Co. v. Commissioner, 321 U. S. 281 ..... 33, 35
Simons, Howard J., 1 B.T.A. 350 13
Wilcox, Commissioner v., 327 U. S. 404 ..... 6, 25, 26

STATUTES

PAGE

Internal Revenue Code:
Sec. 23(f), 26 U.S.C. 1946 ed., Sec. 23 ....3, 6, 19, 29
Sec. 43, 26 U.S.C. 1946 ed., Sec. 43 .....3, 6, 30, 32

Revenue Act of 1918, c. 18, 40 Stat. 1057:
Sec. 214(a)(6) 30

Revenue Act of 1921, c. 136, 42 Stat. 227:
Sec. 214(a)(6) 7, 20, 30
Sec. 234(a)(4) 7, 20, 30

Revenue Act of 1924, c. 234, 43 Stat. 253:
Sec. 200(d) 7, 21, 32

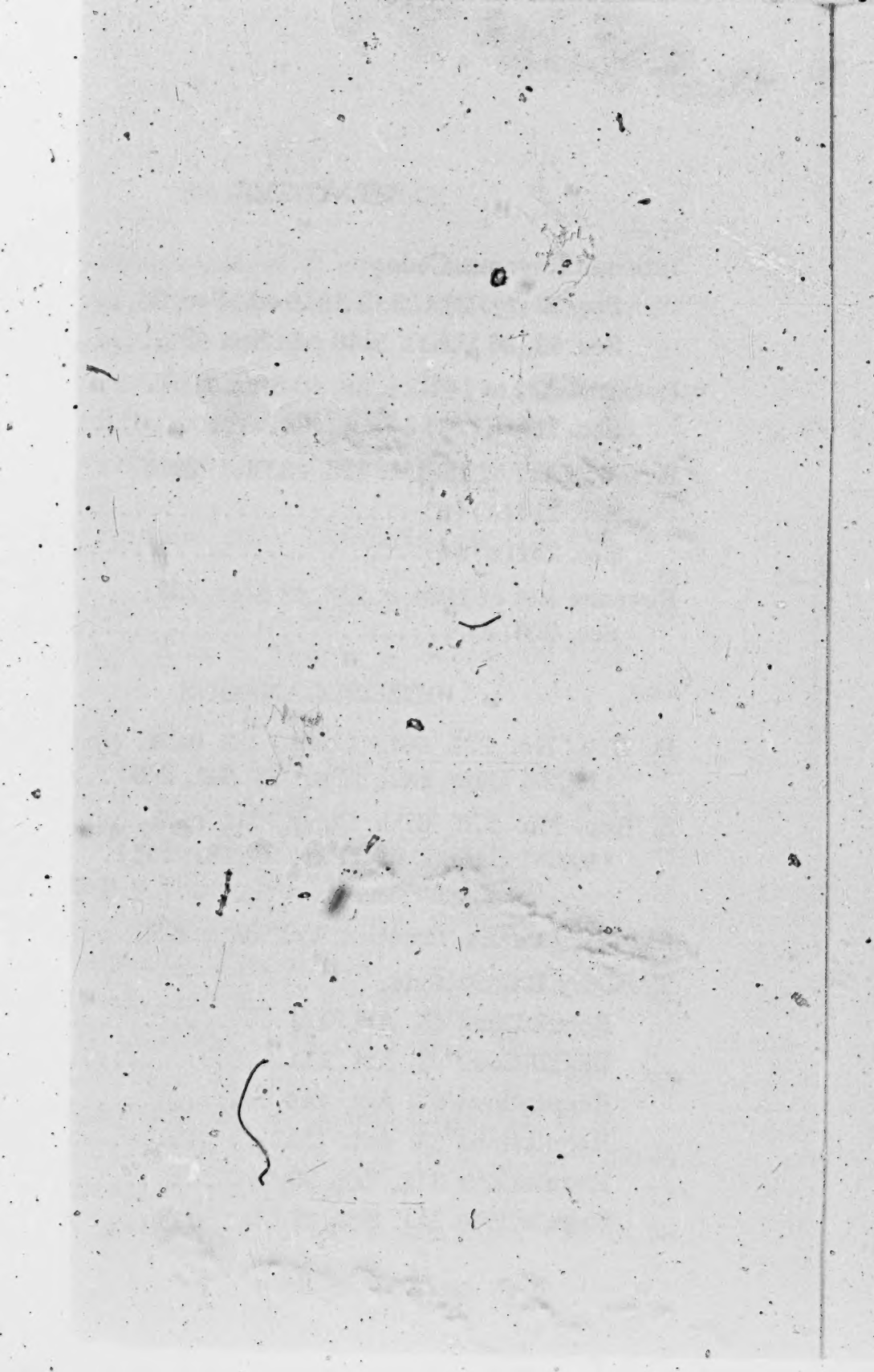
MISCELLANEOUS

H. Rep. No. 179, 68th Cong., 1st sess., pp. 10-11 (1939-1 Cum. Bull. [Part 2], 241, 249) 7, 21, 32

S. Rep. No. 275, 67th Cong., 1st sess., pp. 14-15 (1939-1 Cum. Bull. [Part 2], 181, 191) .....
.....5, 7, 20, 22, 30

Standard Penna. Practice, Vol. 10, p. 601..... 27

Treasury Regulations:
Regulations 45, Art. 111.....17, 31
Regulations 62, Art. 111.....17, 31
Regulations 62, Art. 146.....7, 31, 35
Regulations 65, Art. 1523..... 32
Regulations 111, Sec. 29.43-2.....3, 5, 17
Regulations 111, Sec. 29.23(e)-1..... 24



IN THE

Supreme Court of the United States

OCTOBER TERM, 1952

NO. 80

THE UNITED STATES OF AMERICA,
Petitioner,

v.

STEVENSON-CHISLETT, INC.,
Respondent.

On Certificate from the United States Court of Appeals for the Third Circuit.

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the District Court (R. 3a-11a) is reported at 98 F. Supp. 252. The Court of Appeals did not issue an opinion.

JURISDICTION

The judgment of the United States District Court for the Western District of Pennsylvania in favor of the plaintiff, Stevenson-Chislett, Inc., against the defendant, The United States of America, was entered on June 28, 1951. The defendant appealed the case to the Court of Appeals for the Third Circuit, which, on May 23, 1952, certified to this Court the question of law hereinafter stated (R. 13-16). On June 9, 1952, this Court ordered the entire record in this case sent up so that this Court might decide the entire matter in controversy (R. 16). The jurisdiction of this Court rests on section 1254(3) of Title 28 of the United States Code.

QUESTION PRESENTED

When a taxpayer has suffered embezzlements over a period of years prior to 1945 but the actual years in which the several acts of embezzlement took place are unknown and it is a practical impossibility to ascertain them, are the losses resulting from such embezzlements deductible by the taxpayer under Section 23 of the Internal Revenue Code in computing its taxable net income for the year 1945, in which year the embezzlements were discovered and the net loss therefrom was ascertained?

STATUTE AND REGULATIONS INVOLVED

Section 23(f) of the Internal Revenue Code, 26 U. S. C. Sec. 23, provides:

"Sec. 23. DEDUCTIONS FROM GROSS INCOME.
In computing net income there shall be allowed as deductions:

* * * * * * *

(f) LOSSES BY CORPORATIONS. — In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise."

Section 43 of the Internal Revenue Code, 26 U.S.C. Sec. 43, provides:

"Sec. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits . . . provided for in this chapter shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred', dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period . . ."

Treasury Regulations 111, promulgated under the Internal Revenue Code, state:

"Sec. 29.43-2. When Charges Deductible. —

* * *

A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily deductible for the year in which sustained."

COUNTER-STATEMENT OF THE CASE

The Statement of the Case presented in the Government's brief (pp. 5-7) is accurate, except that the following additional matter in the record should be mentioned:

Initially, the respondent claimed the loss resulting from the embezzlement as a deduction for the year 1944. Upon audit of the respondent's 1944 tax return, officers of the Bureau of Internal Revenue took the position that the loss was not deductible in 1944 because it was not discovered or ascertained until 1945, and disallowed the deduction claimed for 1944. The respondent yielded to this position, filed a claim for refund of income tax for 1945 and subsequently instituted this action. The respondent does not, of course, claim the deduction for both years (Tr. 50).

SUMMARY OF ARGUMENT

A. The general rule of the older lower court cases is that an embezzlement loss is deductible for the year in which the act of embezzlement took place, even though the embezzlement may not be discovered until a later year. There is, however, a well recognized exception to this general rule: if the taxpayer is unable to discover when the embezzlement occurred, the loss is deductible for the year in which the embezzlement is discovered and the amount ascertained. *Boston Consolidated Gas Co. v. Commissioner,* 128 F. 2d 473 (1st Cir., 1942). The cases relied on by the Goverment, such as *Borden v. Commissioner,* 101 F. 2d 44 (2nd Cir., 1939) and *First National Bank of Sharon v. Heiner,* 66 F. 2d 925 (3rd Cir., 1933) are distinguishable because the year in which the actual embezzlement occurred was

known. Those cases do not hold that an embezzlement loss must be deducted for the year of occurrence if the year of occurrence cannot be ascertained.

The applicable Treasury Regulations providing that a loss from theft or embezzlement occurring in one year and discovered in another is *ordinarily* deductible for the year in which sustained, clearly recognize that in *extraordinary* cases embezzelement losses may be deducted for a year other than that in which the act of embezzlement occurred. *Boston Consolidated Gas Co. v. Commissioner, supra; Gwinn Brothers & Co.*, 7 T. C. 320 (1946). The Treasury Regulations have remained unchanged since those decisions.

B. The *Boston Consolidated Gas* line of cases is not in disregard of the statutory language contained in Section 23(f), but is a proper interpretation of the statute. Congress intended the statute to be flexible in order, in the interests of justice to the taxpayer, to permit elastic treatment of such losses (S. Rep. 275, 67th Cong., 1st sess., pp. 14-15, 1939-1 Cum. Bull. [Part 2] 181, 191), and this Court has construed it as calling for a practical and not a legal test. *Burnet v. Huff*, 288 U. S. 156 (1933). From a practical standpoint, a taxpayer should not be required to deduct a loss as of a particular time when he has no way of knowing when that time was. This construction of the statute is in accord with the basic principle reiterated by this Court in *Dixie Pine Products Co. v. Commissioner*, 320 U. S. 516 (1944), that liabilities that remain uncertain or unknown during the taxable year do not constitute allowable deductions for such year, but are deductible only when the liability has become fixed and definite and reasonably ascertainable in amount.

C. Older cases in the lower courts established a general rule, relied on by the Government, that embezzlement losses are deductible only in the year of occurrence on the ground that there is no debtor-creditor relationship. But *Commissioner v. Wilcox*, 327 U. S. 404 (1945), held that an embezzler realizes no taxable income at the time of his embezzlement because there is a definite and unconditional debtor-creditor relationship so that the embezzler has a concurrent obligation to repay. Logically, therefore, his victim does not "sustain" a loss at the time of embezzlement, but only when the embezzlement has been discovered and it is determined what amount of the embezzled funds is not recoverable. *Boston Consolidated Gas Co. v. Commissioner*, 128 F. 2d 473, 477 (1st Cir., 1942); *Gwinn Brothers & Co.*, 7 T. C. 320, 325 (1946).

Section 23(f) permits the deduction of losses sustained during the taxable year unless "compensated for by insurance or otherwise". Even if, despite the reasoning of this Court in its *Wilcox* opinion, the embezzlement loss is regarded as "sustained" in the year the act of embezzlement occurs, the unqualified duty and obligation of the embezzler to repay the money would at the very least bring the loss within the scope of the statutory phrase "compensated for by insurance or otherwise" and the loss would be a permissible deduction in the year it is determined the extent to which the embezzled funds are recoverable.

D. In any event, under Section 43 of the Internal Revenue Code, a loss, such as an embezzlement or casualty loss, should be allowed as a deduction in the year it becomes known regardless of when it was

"sustained", if such allowance is necessary to clearly reflect income. The legislative history of antecedent provisions contained in earlier Revenue Acts demonstrates Congressional intent that such losses occurring in one year and discovered in another fall within the scope of Section 43. Sections 214(a)(6) and 234(a)(4) of the Revenue Act of 1921 permitted losses, including embezzlement losses, to be deducted for a year other than that in which sustained where necessary to clearly reflect income. This provision was applicable to a loss from an embezzlement occurring in one year, but not becoming known until a later year. Reg. 62, Art. 146; S. Rep. No. 275, 67th Cong., 1st sess., pp. 14-15, 1939-1 Cum. Bull. [Part 2] 181, 191. Although this provision did not appear in the same section in the Revenue Act of 1924, it was not omitted from the statute. On the contrary, it was broadened to cover not only losses, but all deductions and credits, and was incorporated in Section 200(d) of the 1924 Act. H. Rep. No. 179, 68th Cong., 1st sess., pp. 10-11, 1939-1 Cum. Bull. [Part 2] 241, 249. That section was the predecessor of, and its language, in so far as here material, was substantially similar to the present Section 43 of the Internal Revenue Code, which was in force during 1945. Thus, the provision of the 1921 Act permitting losses to be deducted for other than the year in which sustained, though extended by the 1924 Act to all deductions and credits, is still in effect. Under that provision in its broadened form, the taxpayer, since it does not know when its money was embezzled, should be permitted to deduct its loss for 1945, the year of discovery. Otherwise it will never get any deduction for its loss contrary to the plain intent of Congress.

ARGUMENT

I. When the Time of Actual Embezzlement Is Unknown the Deduction of an Embezzlement Loss in the Year of Discovery Is Supported by the Decided Cases and by the Applicable Treasury Regulations.

Where a taxpayer has suffered a loss from embezzlement, the so-called general rule of the lower courts is that the loss is deductible in the year in which the act of embezzlement took place. As the Government contends (p. 15), this is ordinarily true under the existing decisions even though the embezzlement is not discovered until a later year. There is, however, a well-established exception to the general rule in those cases in which the taxpayer is unable to determine when the embezzlement took place. Under such circumstances the lower courts have held the loss allowable as a deduction for the year in which it is discovered by the taxpayer and its amount ascertained. Several of these decisions have been acquiesced in by the Commissioner of Internal Revenue and, therefore, despite the Commissioner's implication to the contrary in his letter of October 1, 1952, appearing in Appendix B of the Government's brief (pp. 59-61), his subordinates in the Bureau are under instruction to follow them in the administrative disposition of similar cases. While the Commissioner's letter may show an unfortunate lack of uniformity in the administrative handling of taxpayers' cases in the various field offices of his Bureau, it does not alter the fact that his continuing acquiescence in a decision of the Tax Court constitutes instructions to his subordinates to follow it.

Argument.

In *Boston Consolidated Gas Co. v. Commissioner*, 128 F. 2d 473 (1st Cir., 1942), the taxpayer discovered in 1935 that its treasurer had embezzled a substantial sum, and it was able to recover only part of the funds. The taxpayer was unable to determine in what year prior to 1935 the great bulk of the embezzlement had occurred and it claimed the loss as a deduction in 1935. The Commissioner contended, however, that only the small amount actually embezzled in 1935 was deductible in that year. The court, in deciding the case for the taxpayer, recognized that in the ordinary case an embezzlement loss is deductible for the year in which the embezzlement occurs even though it is not discovered until a later year. The court stated, however, that although this general rule is appropriate in the ordinary case, Congress intended it to be flexible and subject to modification to avoid unjust results. It pointed out that the applicable Treasury Regulations support this conclusion in that they provide only that embezzlement losses are *ordinarily* deductible for the year in which the taking actually occurs. In an unusual case, as where the taxpayer cannot determine the exact year or years involved, the Regulations do not prohibit deduction for the year in which the loss is discovered and the amount ascertained. The court emphasized the injustice that would result from a rigid and inflexible application of the general rule to all cases, pointing out that in most cases justice could be achieved by filing amended returns for the years in which the embezzlements took place, but that here the taxpayer did not know the years involved. The court therefore held that the taxpayer was entitled to deduct the full amount claimed in 1935, the year in which the loss was discovered and its amount

ascertained. The Government did not file a petition for certiorari.

In *Glenn v. Louisville Trust Co.*, 124 F.2d 418 (6th Cir., 1942), the court arrived at a similar result with respect to a type of loss analogous to an embezzlement loss. It held that a loss arising out of a fiduciary's unauthorized investment which became worthless was not deductible until the loss had been discovered and its extent ascertained. In urging that the *Boston Consolidated Gas* case is unsupported by any precedent (p. 20), the Government mentions the *Louisville Trust Co.* case and dismisses it from consideration on the ground it did not deal with the time for deduction of an embezzlement loss. But similar tax problems should be governed by similar principles, and we respectfully submit that the *Louisville Trust Co.* case is a precedent, the basic reasoning of which supports the decision reached in the *Boston Consolidated Gas* case.

This exception to the general rule of the older cases —that embezzlement losses are deductible for the year in which the act of embezzlement occurs—has also been recognized and followed by the Tax Court consistently for the past ten years:

Shortly after the decision in the *Boston Consolidated Gas* case, the Tax Court followed the general rule on the facts involved in *Maria G. Miglietta*, 1 T.C.M. 499 (1943), since the exact year of the occurrence of the embezzlement was known. However, the Tax Court expressly recognized that when there are extraordinary facts, such as where the taxpayer cannot ascertain the year of embezzlement, the rule of the *Boston Consolidated Gas* case applies and the taxpayer is entitled to

deduct the loss in the year of discovery. It is wrong, therefore, for the Government to cite this case in its favor (p. 15).

In *Samuel M. Felton,* 5 T.C. 256 (1945), the taxpayer in 1938 gave an agent $20,000 to invest for him. Since 1933 the agent had been in the business of managing funds for others under contracts which permitted the intermingling of funds. In 1940 the agent absconded, and thereafter in the same year the taxpayer learned that all the agent's monthly statements had been false and that he had actually been insolvent since 1933. The taxpayer claimed that the loss was deductible in 1940 when he first discovered the embezzlement, but the Commissioner contended that the loss was incurred sometime prior to 1940. The Tax Court allowed the loss in 1940, pointing out that until the agent absconded his scheme of manipulation was working, that because of the intermingling of funds it was impossible for the taxpayer to ascertain the exact year in which his own funds had been misappropriated, and that under these facts he should not be compelled to do so. This decision was followed on the same facts in *Lucy D. Gilpin,* 6 T.C.M. 370 (1947), where the taxpayer wanted a different year and the Commissioner successfully argued that the *Felton* case was right and should be followed.

In *Gwinn Brothers & Co.,* 7 T.C. 320 (1946), the taxpayer discovered in 1935 that one of its employees had been embezzling its funds for an indefinite period of years, and that the employee was insolvent and the funds could not be recovered. The amounts embezzled during the years 1932 through 1935 were ascertained, and deductions therefor were allowed by the Commissioner

for those years. The amounts embezzled prior to 1932, however, were not allocable to particular years, and the taxpayer deducted this balance of the embezzlement loss in 1935, the year of discovery. As to this amount in controversy, the Tax Court held that since the taxpayer had no way of ascertaining the year or years of embezzlement, the loss was sustained and deductible in 1935. The Tax Court discussed with approval the *Boston Consolidated Gas* case, and added (p. 325):

> ". . . the petitioner, under the above facts, could not in any particular year prove loss of any particular amount. We think, therefore, that this case falls outside the 'ordinary rule' as announced in various cases (prior to the *Wilcox* case, *supra*), and that the cases relied upon by the respondent should not here control."

It is noteworthy that the Commissioner of Internal Revenue has published his acquiescence in the *Felton* and *Gwinn* cases. 1945 Cum. Bull. 3; 1946-2 Cum. Bull. 2. It is true, as the Government says (p. 18), that as to *Gwinn* the acquiescence was as to result only; but the acquiescence as to *Felton* was unlimited. In addition, no petition for certiorari was filled by the Government in the *Boston Consolidated Gas* case. These decisions have been in force and unchallenged for some time, and notwithstanding the letter written by the Commissioner last month for use in the Government brief (p. 59), were doubtless the reason why the taxpayer in this case was told by Bureau officers that the deduction should be claimed in 1945 rather than 1944 (Tr. 50).

The Government cites fifteen older decisions in support of its position that an embezzlement loss may be

deducted only for the year in which the actual taking occurs (p. 15). But in only one of these fifteen was the actual year of embezzlement unknown: *J. A. Bentley*, 5 B.T.A. 314 (1926). In all the other cases the taxpayer knew the exact year in which the act of embezzlement had occurred. Those decisions, therefore, merely apply the "ordinary" rule of the Regulations to the ordinary case, and are fully reconcilable with the *Boston Consolidated Gas* line of cases. And the *Bentley* case itself has been effectively overruled by the numerous recent Tax Court decisions, following *Boston Consolidated Gas*, dealing with an unknown year of embezzlement.

The Government asserts (pp. 15-16) that there are two cases involving "losses from thefts deductible in years of theft and not in later years when first discovered." However, *Howard J. Simons*, 1 B.T.A. 350, did not involve a refusal to allow a 1921 loss by theft "not discovered until 1922" (p. 25). Instead, there were two alleged thefts, one in 1921 and one in 1922. As to the 1921 theft, it was discovered in 1921, and held not deductible in 1922; as to the 1922 alleged theft, it was held the evidence did not prove there was a theft. *Borden v. Commissioner*, 101 F.2d 44 (2d Cir., 1939), being another application of the ordinary rule to the ordinary case, is also not in point. One Coutant, representing himself to be an attorney, obtained a sum of money from the taxpayer in 1931 under false pretenses. Before the end of 1931 the taxpayer became suspicious and retained another attorney to investigate the matter. Early in 1932 is was discovered that Coutant was an ex-convict and not an attorney at all, and that the taxpayer had been defrauded. On these facts the court held that the

loss was deductible in 1931 rather than 1932, saying (p. 45):

> "Coutant never meant to restore the money; it was a retainer, paid to him as his own, intended for him to keep. He was not a disloyal trustee who expected to make good a defalcation, but an ordinary rogue who meant to disappear with his loot before he was detected; at least Borden, who had the burden, has not shown the contrary. These considerations would indeed dispose of the case, even if the fraud had not been discovered until it was too late to get a refund for 1931; but that argument, whatever it may be worth, is met by the fact that Borden learned everything probably by March 15, 1932, when his return for 1931 was due, but in any case in ample season to get a refund, if he had already paid his tax for that year."

On the facts of that case, it is apparent that not only was the year in which the taking occurred known to the taxpayer, but also the loss was discovered in ample time to permit the deduction to be claimed for such year. Thus, the *Borden* case is just another application of the general rule to the "ordinary" case.

The Government quotes (pp. 14-15) from the decision of this Court in *Burnett v. Huff*, 288 U. S. 156 (1933). The concession made by the Government in that case and referred to by the Court (p. 159) merely restates the general rule applicable to the ordinary case where the year of embezzlement is known; it does not purport to deal with the extraordinary factual situation involved in the *Boston Consolidated Gas* case and here. In the *Huff* case, one of two partners embezzled

money in 1920 from a trust fund held by the firm, and paid it to the other partner in discharge of a debt which the firm owed to him. The innocent partner discovered the embezzlement in 1920, and in 1921 he restored the full amount to the fund, paying part with the firm's assets and part from his own funds. This Court, in holding that the amount repaid in 1921 could not be deducted as a loss in 1920, said (p. 161):

> "The requirement that losses be deducted in the year in which they are sustained calls for a practical test."

Certainly there is nothing "practical" about the Government's position which would require a taxpayer to determine the exact year in which an embezzlement occurred when, on the facts, that is impossible. On the other hand, the *Boston Consolidated Gas* line of cases does furnish a practical and a fair test for determining the year of deductibility of an embezzlement loss in those situations where the exact year of the taking is unascertainable.

The Government also relies on *First National Bank of Sharon v. Heiner*, 66 F.2d 925 (3rd Cir., 1933), but as pointed out in the opinion of the District Court, that case is clearly distinguishable on its facts from the *Boston Consolidated Gas* case and the present proceeding (R. 9a-10a). In the *Sharon Bank* case, the exact dates on which the acts of embezzlement took place were known, and this fact also distinguishes *Alison v. United States* (pending before this Court at No. 79), as noted by the Government in its brief (pp. 10, 12). Whether those decisions are correct on their particular facts or whether, on the other hand, the *Alison* case should be reversed

as being erroneous in principle, is a question to which we need not address ourselves under this head of argument dealing with the precedents in point. It is enough for us to point out that those cases are distinguishable on a material fact and, hence, are not contrary to the decisions on which we rely.

Analysis of the foregoing decisions shows that when the Government argues (p. 17) that "repeated reenactment of the statute demonstrates that Congress intended that the word 'sustained' be so interpreted", it is arguing for the taxpayer. This is so because, as we have seen, almost without exception the older cases relied on by the Government did not involve an unknown year of embezzlement. The *Boston Consolidated Gas* case and the numerous Tax Court cases following it have allowed the deduction in the year of discovery where the year of embezzlement was unknown, and Congress has not disapproved. And the same criticism may fairly be made of the Government argument that Congress has remedied other inequities but has not remedied this one (pp. 40-51). From this statement the Government concludes that Congress is satisfied with the inequity. But the fact is that where the year of embezzlement is unknown, the decisions have favored the taxpayer. The right conclusion, we submit, is that Congress is satisfied with the equitable result of the *Boston Consolidated Gas* line of cases.

We believe that the distinction we make of the Government's cases is sensible. If it is known exactly when and how much has been embezzled, a loss can be claimed for that year, at least within the period permitted by the applicable statute of limitations. But if

the years are not known and cannot be ascertained, then the loss can be claimed, if it is to be claimed at all, only when discovered.

The distinction, we submit, is recognized by Treasury Regulations. Section 29.43-2 of Regulations 111 provides:

> "* * * A loss from theft or embezzlement occurring in one year and discovered in another is *ordinarily* deductible for the year in which sustained." (Italics ours)

The plain meaning of the words used according to common usage and in context necessarily implies that in some extraordinary factual situations the loss may be deducted for a year other than the one in which the actual taking occurs. Reading this Regulation in the light of the prior Regulation on the subject serves to emphasize this necessary implication. Regulations 45, Article 111, promulgated under the Revenue Act of 1918, provided that "A loss from theft or embezzlement occurring in one year and discovered in another is deductible *only* for the year of its *occurrence.*" (Italics ours). However, Regulations 62, Article 111, promulgated under the Revenue Act of 1921, changed this language to provide that an embezzlement loss "occurring in one year and discovered in another is *ordinarily* deductible for the year in which sustained" (Italics ours), and that provision has remained unchanged in all subsequent Regulations up to the present time. Reading these two Regulations together, it is apparent that under the newer Regulation embezzlement losses may, in *extraordinary* cases, be deducted for a year other than that in which the act of taking occurred, and the

Regulation has been so construed by the courts. *Boston Consolidated Gas Co. v. Commissioner*, 128 F.2d 473, 476; *Gwinn Brothers & Co.*, 7 T. C. 320, 324.

This Regulation has existed in its present form for nearly thirty years, and during that period the statutory provisions governing the time for deduction of embezzlement losses have been reenacted without substantial change on numerous occasions. It is well established that Treasury Regulations long continued without change, applying to reenacted statutes, are deemed to have received Congressional approval and have the effect of law. *Boehm v. Commissioner*, 326 U.S. 287, 291-292 (1945); *Lykes v. United States*, 343 U.S. 118, 127 (1952). The Government seeks to avoid the damaging effect of the word "ordinarily" by arguing that its retention in Treasury Regulations after 1924 was "apparently an oversight" and the word is only a "vestigial appendix" (pp. 34-35). The simple answer is this "oversight" was forcefully called to the attention of the Commissioner in 1942 by the *Boston Consolidated Gas* case, and in the ten years since that time the Regulations in this respect have not been changed. Accordingly, in a case not the ordinary case, an embezzlement loss is not deductible only in the year "occurring". If this case is not out of the ordinary, we cannot conceive of what would be regarded by the Government as the extraordinary case. When the "occurring" year is unknown, the case is not ordinary.

The facts in the present case are similar to those involved in the *Boston Consolidated Gas* case and the cases which follow it, and are readily distinguishable from the cases relied on by the Government. The findings of fact show that the taxpayer first discovered

this loss in 1945; that, without fault on the part of the taxpayer, the particular year or years in which the acts of embezzlement took place could not be ascertained; and that it was determined in 1945 that the taxpayer had no enforceable claim for recovery of the missing funds. We respectfully submit, therefore, that this case falls outside the "ordinary" rule and that, under the precedents in point and the applicable Regulations, the taxpayer is entitled to deduct the loss in 1945, the year of discovery.

II. A Proper Construction of the Statute Permits the Deduction of an Embezzlement Loss in the Year of Discovery When the Year of Actual Taking Is Unknown.

The Government admits (p. 18) that the present case is indistinguishable from the *Boston Consolidated Gas* case. The gist of its argument is that the decision of the Court of Appeals for the First Circuit, while equitable, is contrary to the language of the statute, and to the principle that statutes resulting in oppressive conditions can be altered only by Congress and not by the courts.

Section 23(f) provides that in computing the net income of corporations there shall be deducted "* * *, losses *sustained* during the taxable year and not compensated for by insurance or otherwise." (Italics ours). The Government assumes that this provision reads "losses occurring during the taxable year," and then argues that the Court of Appeals for the First Circuit, in order to avoid an oppressive and harsh result, judicially modified the "plain" words of the statute by

allowing a deduction in a year other than the year of occurrence of the loss. It is true that the decision of the First Circuit avoided a harsh and oppressive result, but it does not follow that the decision is contrary to the language of the statute or to the general principles heretofore announced by this Court as guides to the time for the deduction of losses. Despite the Government's assumption to the contrary, embezzlement losses on facts such as those involved in the *Boston Consolidated Gas* case and the instant case, are not necessarily "sustained" in the year of taking within the meaning of the statute.

Section 214(a)(6) of the Revenue Act of 1921, 42 Stat. 227, 240, dealing with deductions by individuals, provided that certain losses, such as losses from theft, should be deducted as of the taxable year in which sustained unless, in order to clearly reflect the income, the loss should, in the opinion of the Commissioner, be accounted for as of a different period. The corresponding section for corporate taxpayers was section 234(a)(4), which contained a similar provision. In explaining the purpose of this provision, the report of the Senate Finance Committee (S. Rep. No. 275, 67th Cong., 1st sess., pp. 14-15, 1939-1 Cum. Bull. [Part 2] 181, 191) states:

> "* * * To permit *more elastic treatment* of such losses, *in the interests of justice to the taxpayer,* it is provided that certain losses shall not be deducted as of the taxable year in which sustained, if in the opinion of the Commissioner they should be accounted for as of a different period;" (Italics ours).

Argument.

In the Revenue Act of 1924 the provision permitting loss deductions to be taken for a year other than the one in which sustained, in order to reflect income clearly, was shifted to section 200(d) (what is now section 43 of the Internal Revenue Code) and was broadened to cover all deductions and credits rather than just losses. H. Rep. No. 179, 68th Cong., 1st sess., pp. 10-11; 1939-1 Cum. Bull. [Part 2] 241, 249. In addition, the phrase "in the opinion of the Commissioner" was omitted from the provision in the Revenue Act of 1924 and has not appeared in the corresponding provision of any subsequent Revenue Act.

Although the particular provision explained in the above quotation of the Senate Finance Committee does not appear in section 23(f), the present counterpart of section 234(a)(4) of the 1921 Act, the quotation is nevertheless appropriate to show a basic intention of Congress to enact statutory provisions covering the time for deduction of losses that would be sufficiently elastic to provide a fair and just result. If the taxpayer is not permitted to deduct this embezzlement loss in 1945, it will never obtain a deduction for such loss—a most inequitable result. It should, therefore, be permitted to treat the loss as "sustained" in the year of discovery, unless the plain words of the statute *require* the deduction only in the year or years of occurrence of the acts of embezzlement.

The statute permits the deduction of losses *sustained* during the taxable year, but nowhere does it define what is meant by the word "sustained". That this can mean something different from losses *occurring* during the taxable year is perhaps most clearly demon-

strated by a further quotation from the report of the Senate Finance Committee cited above. In explaining the purpose of section 214(a)(6) of the 1921 Act, the report states (S. Rep. No. 275, 67th Cong., 1st sess., pp. 14-15, 1939-1 Cum. Bull. [Part 2] 181, 191):

> "* * * losses *occurring* in one year are frequently not *determined or sustained* until another year, depending upon court decision or the clearing up of uncertainty. * * *" (Italics ours).

The above quotation shows that the Senate Finance Committee recognized that a loss is not always "sustained" in the year of occurrence. The Committee used the word "sustained" as having a meaning similar to "determined", and used both those words as meaning something different from "occurring".

It is apparent that the statutory expression "losses sustained during the taxable year" is not so fixed and inflexible a concept as to be incapable of judicial interpretation, and that the Government's position, that the *Boston Consolidated Gas* decision and the decision of the District Court in this case are in disregard of the plain language of the statute, is unwarranted. In construing this statutory expression, this Court has on several occasions announced that the requirement that losses be deducted in the year in which they are sustained calls for a *practical,* not a legal, test:

In *Lucas v. American Code Co.,* 280 U. S. 445 (1930), a taxpayer breached a contract in 1919, lost a jury verdict in 1922, lost on appeal in 1923, and paid the judgment in 1923. It claimed the loss for 1919 on the theory that "all the facts which gave rise to the liability were fixed in that year", but this Court held that the loss was

not "as a matter of law or of undeniable fact, sustained in 1919. Nor did the Company so regard it" (p. 452). That language is most appropriate in the case at bar; the taxpayer could not "regard" the embezzlement as a loss before 1945 because it did not know about it. And Your Honors held (p. 449):

> "The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal test."

In *Burnet v. Huff*, 288 U. S. 156 (1933), another decision dealing with the interpretation of the statutory requirement that losses be deducted in the year in which sustained, this Court held (pp. 160-161):

> "And whether a taxpayer will actually sustain a loss through embezzlement of trust funds of which he is trustee will depend upon a variety of circumstances. If there is liability on his part for the misappropriation, it does not create a certainty of loss, as the defalcation may be made good by the one who caused it, or the liability of the taxpayer may be enforced only to a limited extent or not at all. The requirement that losses be deducted in the year in which they are sustained calls for a practical test."

And in *Boehm v. Commissioner*, 326 U. S. 287 (1945), a case dealing with the question of the time for deduction of a loss resulting from stock becoming worthless, this Court, after citing with approval *Lucas v. American Code Co., supra*, stated (p. 293):

> "The standard for determining the year for deduction of a loss is thus a flexible, practical one, varying according to the circumstances of each case."

Such statements by this Court not only demonstrate that the statutory language is such as to require judicial interpretation, but also show that the statute provides a degree of flexibility, so that the year in which the loss is sustained may be determined in the light of the facts of the particular case and a practical result may be thereby achieved. Certainly the Court of Appeals in the *Boston Consolidated Gas* case applied a "practical" test in deciding that a loss need not be deducted in the year of the happening of an event, if it is not known when that event happened. This is not judicial legislation, but rather an entirely appropriate construction of a statutory provision intended to be flexible.

A construction of the statute permitting the deduction of an embezzlement loss in the year of discovery, where the year of actual taking is unknown, is required by another principle, enunciated in the *Boehm* case, 326 U.S. 287, 291, that losses actually sustained during a taxable period must be fixed by identifiable events. To the same effect is the provision of Treasury Regulations 111, Section 29.23(e)-1, that losses "must be . . . fixed by identifiable events." On facts such as were involved in the *Boston Consolidated Gas* case and are involved here, the loss cannot be regarded as sustained, within the meaning of the statute, in any year prior to the year of discovery, since there is no "identifiable event" to fix the loss in any of the prior years.

Such a construction of the statute is in accord with the basic principle, applicable to items of deduction generally, reiterated by this Court in *Dixie Pine Products Co. v. Commissioner*, 320 U.S. 516 (1944), that liabilities

that remain uncertain or unknown during the taxable year cannot be accrued as deductions for such year, but are deductible only when the liability has become fixed and definite and reasonably ascertainable in amount. If, as in *Dixie Pine*, a taxpayer who contests a tax may not accrue his liability therefor so long as it remains uncertain whether he will ever have to pay it, the victim of an embezzlement loss should not be required to claim a deduction for his loss while it is not only uncertain what the ultimate loss will be, if any, but also while the very fact that there has been an embezzlement is unknown. Such a loss is neither fixed nor definite nor reasonably ascertainable in amount.

III. The Logical Corollary of the Rule That an Embezzlement Creates a Debtor-Creditor Relationship Is That the Victim of the Embezzlement Does Not Sustain a Loss Until the Embezzlement Is Discovered and Its Amount Determined.

The Government relies on numerous cases in the lower courts which set forth an "ordinary rule" that embezzlement losses are deductible in the year the money is taken (p. 15). We have already considered the point that this case, since the year of the taking is unknown, is the extraordinary rather than the ordinary case. But we go further: we point out that every one of the cases relied upon by the Government was decided prior to the decision of this Court in *Commissioner v. Wilcox*, 327 U.S. 404 (1945). The *Wilcox* case held that an embezzler realizes no taxable income from the embezzlement because at the time of the taking he automatically becomes

obligated to repay the money to his victim. In view of this decision, we submit that these older cases of the lower courts setting forth the so-called ordinary rule can no longer be applied to a case where the embezzlement is not discovered and the amount ascertained until a subsequent year, whether or not the exact year in which the taking occurred subsequently becomes known.

The reasoning of these older cases is made clear in *Peterson Linotyping Co.*, 10 B.T.A. 542 (1928), where the Board of Tax Appeals held that an embezzlement loss is deductible only when the money was taken because (p. 544)

> "We think that the conclusion reached in that case is sound and applicable here and that the embezzlement by Budde from the Regan Printing House, Inc., constituted a loss to the company but did not create the relation of debtor and creditor."

And this is the basis of the cases cited by the Government (p. 15).

But in *Commissioner v. Wilcox* this Court reasoned (pp. 408-409):

> "Under Nevada law the crime of embezzlement was complete whenever an appropriation was made; the employer was entitled to replevy the money as soon as it was appropriated or to have it summarily restored by a magistrate. The employer, moreover, at all times held the taxpayer liable to return the full amount. *The debtor-creditor relationship was definite and unconditional.* All right, title and interest in the money rested with the employer." (Italics ours).

The Pennsylvania law is not different here from the Nevada law. 10 *Standard Penna. Practice* 601.

It is true, as the *Wilcox* case said (p. 409) and as the Government's brief points out (p. 17), that generally there need not be a relationship between income to one taxpayer and a deduction to another. Nevertheless, the reasoning underlying the decision that the embezzler did not realize taxable income was that he was at all times under an unqualified duty and obligation to repay the money and that, therefore, a definite and unconditional debtor-creditor relationship had been established. In view of this reasoning, a rule of the lower courts based on the premise that embezzlement does "not create the relation of debtor and creditor" cannot stand.

Since a lender sustains no loss at the time he makes a loan, the logical corollary of this Court's reasoning in the *Wilcox* case is that the victim of an embezzlement does not "sustain" a loss at the time of the embezzlement, but only when the embezzlement has been discovered and it is determined what portion of the embezzled funds is not recoverable. In his concurring opinion in the *Boston Consolidated Gas* case, decided prior to this Court's decision in the *Wilcox* case, Judge Magruder reasoned that if a wrongdoer makes no gain from his embezzlement (as had been held in *McKnight v. Commissioner*, 127 F.2d 572 (5th Cir., 1942), which was later approved in the *Wilcox* case), then logically the person whose money is taken does not "sustain" a loss at the time of the embezzlement. And, subsequent to the *Wilcox* case, the Tax Court has held that the *Wilcox* case requires the conclusion that an embezzle-

ment loss is deductible when discovered and the amount determined. *Gwinn Brothers & Co.*, 7 T.C. 320, 325 (1946):

> "In addition, under the *Wilcox* case, *supra* (though the question there was to income, the question of debtor-creditor relation was pertinently considered), it seems clear that the embezzlement made the embezzler debtor to the petitioner — and it is stipulated that there was discovery, determination and worthlessness, and charge-off in 1935."

We do not imply that under the *Wilcox* case every embezzlement loss automatically becomes deductible as a bad debt under section 23(k) of the Internal Revenue Code. That section specifically deals with debts becoming worthless and is narrower in scope than sections 23(e) and 23(f) which deal with losses generally. Since a debt in the usual sense results from a voluntary loan which the borrower expressly agrees to repay, we think it entirely appropriate to limit the scope of section 23(k) to bad debts arising from a voluntary debtor-creditor relationship and to embezzlement cases where the embezzler upon discovery agrees to make restitution but becomes unable to keep his promise. Nevertheless the voluntary debtor-creditor relationship of the typical loan and the involuntary debtor-creditor relationship discussed in the *Wilcox* case are sufficiently parallel to call for an application of similar principles. The creditor is not regarded as suffering his bad debt loss at the time he makes the loan; therefore, the victim of an embezzlement should not be regarded as sustaining a loss at the time his funds are surreptitiously taken, but only when the fact of the loss becomes fixed and definite and the amount becomes reasonably determinable.

In any event, even if the embezzlement victim is regarded as having "sustained", in a technical sense, his loss in the year of taking, the reasoning of the *Wilcox* case, coupled with the express terms of the statute, permits the deduction of the loss when the amount recoverable is determined. Congress intended the statutory provision governing the time for the deduction of losses to have some degree of flexibility in order that practical results might be reached, as is shown by the language of the statute itself which provides that taxpayers may deduct losses sustained during the taxable year *not compensated for by insurance or otherwise.* An event resulting in a loss may occur in one year, but the extent, if any, to which the loss is compensated for may not be determinable until a subsequent year. The statute therefore indicates that Congress recognized that the economic impact of the loss is not suffered by the taxpayer until the year in which it is determined whether or not the loss is to be reimbursed by an insurer or other person. As shown by *Piedmont Grocery Co. v. United States,* 66 C. Cls. 468 (1928), *cert. den.* 280 U. S. 554 (1930), relied on by the Government (p. 16), an embezzlement loss is not deductible if the employee is bonded and recovery may be had against the bonding company, even though the recovery may be in a later year.

Since the *Wilcox* case holds that the embezzlement gives rise to a concurrent obligation on the part of the embezzler to repay his victim, then even if the loss be regarded as technically "sustained" in the year of the taking, the phrase "not compensated for by insurance or otherwise" is certainly applicable, and the language of the statute permits the deduction of the loss in the

year when it is determined how much of the embezzled funds are recoverable.

IV. In Any Event, Where the Year of Actual Embezzlement Is Unknown, an Embezzlement Loss Is Deductible in the Year of Discovery in Order to Clearly Reflect the Income of the Taxpayer.

The legislative history of Section 43 of the Internal Revenue Code and of its predecessor provisions contained in earlier Revenue Acts establishes that a loss is to be allowed as a deduction in the year such allowance is necessary to clearly reflect income, regardless of when the loss was "sustained".

Section 214(a)(6) of the Revenue Act of 1918, 40 Stat. 1057, 1066, allowed as a deduction "losses sustained during the taxable year". In the Revenue Act of 1921, Congress added the following sentence to Section 214(a)(6), 42 Stat. 227, 240:

> "Losses allowed under paragraphs (4), (5) and (6) of this subdivision shall be deducted as of the taxable year in which sustained unless, in order to clearly reflect the income, the loss should, in the opinion of the Commissioner, be accounted for as of a different period."

Section 234(a)(4), applicable to corporate taxpayers, contained a similar provision. The purpose of this provision was explained by the Senate Committee on Finance (S. Rep. No. 275, 67th Cong., 1st sess., pp. 14-15; 1939-1 Cum. Bull. [Part 2] p. 191), which said:

> ". . . losses occurring in one year are frequently not determined or sustained until another year, de-

pending upon court decision or the clearing up of uncertainty. To permit more elastic treatment of such losses, in the interests of justice to the taxpayer, it is provided that *certain losses shall not be deducted as of the taxable year in which sustained,* if in the opinion of the Commissioner they should be accounted for as of a different period; . . ." (Italics ours)

The Commissioner made a corresponding change in his regulations. Article 111 of Regulations 45 under the Revenue Act of 1918 had provided:

"A loss from theft or embezzlement occurring in one year and discovered in another is deductible only for the year of its occurrence."

But in Article 111 of Regulations 62 cross reference was made to Article 146, where the Commissioner stated:

"In exceptional circumstances, however, in order to avoid injustice to the taxpayer and to more clearly reflect his income, the Commissioner may permit a loss to be accounted for as of a year other than the one in which sustained. For example, an embezzlement or a shipwreck may occur in 1921 but not become known until 1922 and in such a case income may be more clearly reflected by accounting for the loss as of 1922 rather than of 1921."

Were this case to be decided under the Revenue Act of 1921, therefore, the taxpayer would clearly be right.

Section 214(a)(6) of the Revenue Act of 1924, 43 Stat. 253, omitted the sentence which had appeared in the Revenue Act of 1921 providing for accounting "as of a different period". But the sentence of section 214(a)(6) was not omitted, as the Government asserts

(p. 26), because of a "more mature appreciation" of a "concept of a clear reflection of income". On the contrary, the Ways and Means Committee in its report, H. Rep. No. 179, 68th Cong., 1st sess., p. 10, 1939-1 Cum. Bull. [Part 2] 249, stated:

> "The Revenue Act of 1921 in sections 214(a)(6) and 234(a)(4) authorizes the Commissioner to allow the deduction of losses in a year other than that in which sustained when, in his opinion, it is necessary to clearly reflect the income. The proposed bill extends that theory to all deductions and credits."

This extension of the principle of accounting "as of a different period" was accomplished by new Section 200(d), which declared:

> "The deductions and credits provided for in this title shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred', dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period."

And Regulations 65 contained a new provision, Article 1523, which copied the language of Section 200(d).

The first sentence of Section 43 of the Internal Revenue Code, in force in 1945, is the same as section 200(d) of the Revenue Act of 1924. The principle of the Revenue Act of 1921 that "losses shall not be deducted as of the taxable year in which sustained", with its extension "to all deductions and credits" by the Revenue Act of 1924, is therefore still in effect. And the provision of the

Revenue Act of 1921 giving weight to "the opinion of the Commissioner" was omitted in the Revenue Act of 1924 and subsequent acts so that what the Government calls the Commissioner's "vague discretion" (pp. 23-24) no longer troubles us. The question is no longer one of his opinion but of fact and law.

The reliance of the Government (pp. 21-28) on *Security Flour Mills Co. v. Commissioner*, 321 U. S. 281 (1944), is, we respectfully submit, misplaced. It was there held (pp. 285-286) that the qualifying clause, "unless in order to clearly reflect the income the deductions or credits should be taken as of a different period":

> ". . . was not intended to upset the well-understood and consistently applied doctrine that cash receipts or matured accounts due on the one hand, and cash payments or accrued definite obligations on the other, should not be taken out of the annual accounting system and, for the benefit of the Government or the taxpayer, treated on a basis which is neither a cash basis nor an accrual basis, because so to do would, in a given instance, work a supposedly more equitable result to the Government or to the taxpayer."

The decision was based on the analysis made by Mr. Justice Roberts of the legislative history of the Revenue Act of 1924, from which he concluded (p. 285):

> "From these reports it is clear that the purpose of inserting the qualifying clause was to take care of fixed liabilities payable in fixed installments over a series of years."

That conclusion, with respect to deductible expenses such as prepaid interest or rent or the type of expense

deduction involved in the *Security Flour Mills* case, finds ample support in the committee reports relative to the 1924 Act quoted in the opinion. However, neither the *Security Flour Mills* decision nor the committee report quotations relied on were dealing with the deductibility of *losses* under the qualifying clause.

As recognized in the majority opinion of Mr. Justice Roberts and as shown in the quotation from the committee reports, the insertion of the above-mentioned qualifying clause in the 1924 Act was made to *extend* to other items of deduction and credit an existing provision, contained in sections 214(a)(6) and 234(a)(4) of the Revenue Act of 1921, permitting the deduction of losses in a year other than that in which sustained when that was necessary to reflect income clearly. When, in enacting the 1924 Act, Congress omitted the earlier provision from sections 214(a)(6) and 234(a)(4) and inserted instead the broader qualifying clause in section 200(d), Congress meant to incorporate, not eliminate, the earlier provision with respect to losses.

Thus, although the qualifying clause in its present form was first added to the statute in section 200(d) of the Revenue Act of 1924, it is the 1921 Act, not the 1924 Act, that is the father of the basic concept of the present section 43 of the Internal Revenue Code. The 1921 Act, as we have shown, was concerned exclusively with "losses" and the committee reports and Regulations under that Act made it clear that Congress intended that losses occurring in one year, but determined in another, need not be deducted as of the taxable year in which they occurred. The Congressional purpose in changing this statutory provision and enacting the

broader qualifying clause in section 200(d) of the 1924 Act was as stated by Mr. Justice Roberts, namely, to take care of *additional* situations such as the one of fixed liabilities payable over a series of years. But the situation with respect to "losses" had already been taken care of in the 1921 Act, and the 1924 Act was designed to *extend that theory*, not to restrict it. When the Government says "it is to be doubted" whether section 43 applies to losses (p. 29), it is ignoring the legislative history and, as it admits (p. 18), it is contradicted by the only judicial decision.

We urge that the decision of this Court in the *Security Flour Mills* case (that the 1924 Act's extension of the losses "theory" of the 1921 Act to other deductions and credits was meant to cover only limited situations such as fixed liabilities payable in fixed installments over a series of years) is no bar to a recognition that the legislative history concerning this extension manifests Congressional intention to preserve the earlier provision *as to losses* in full force and effect. That earlier provision as to losses was not limited to losses payable in fixed installments over a series of years; such situations do not exist with respect to losses, and to impose any such limitation with respect to deductions for losses would be to say that the qualifying clause has no application at all to losses, but only to expenses. Indeed, the legislative intent, as the Commissioner's Regulations once declared, was to permit embezzlement or shipwreck losses which occurred in one year and became known in another to be deducted in the year they had "become known". Reg. 62, Art. 146.

In the case at bar, if the taxpayer knew that the money had been embezzled say in 1943 or 1944, it could deduct its loss in that year. It does not, however, know when the money was embezzled, although it used diligent efforts to try to discover the year. If it does not get the deduction in 1945, the year of discovery of the loss, it will not get the deduction in any year whatever. Its income for the years involved would thus not be clearly reflected, but would be distorted contrary to the express will of Congress.

Conclusion.

The decision of the District Court is in accordance with the precedents in point and the applicable Treasury Regulations. It is not in disregard of the statutory language but, rather, is required by a proper construction of the statute and by the basic principles governing the time for deduction of losses and other items. Further, the decision is in accordance with the reasoning of this Court in *Commissioner v. Wilcox;* and, in any event, is required by a proper application of section 43 of the Internal Revenue Code to the facts of this case. Accordingly, the question certified to this Court by the Court below should be answered in the affirmative and the judgment of the District Court affirmed.

Respectfully submitted,

DAVID B. BUERGER,
GEORGE M. HEINITSH, JR.,
1301 Alcoa Building,
Pittsburgh 19, Pennsylvania,
Attorneys for the Respondent.

November, 1952.